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Gartner for Supply Chain

Increase Supply Chain Risk Awareness



Introduction

No company is immune and has complete mitigation readiness with scenario-based action plans for disruptions in the supply chain. That, however, is not an excuse for improved readiness and enhanced competitiveness through synchronized business and supply chain/procurement strategies. This issue is often accompanied by a lack of advanced planning and risk-reward-based supply chain execution. High-risk aversion drives noncompetitiveness in the long run, whereas intense risk taking quickly creates an environment with uncontrolled engagements with potential negative consequences to operations, which are typically discovered after impact. Containment, corrective actions and recovery are reactively orchestrated with business continuity in focus, and once recuperated, a postmortem rarely changes existing processes for the better. Changes are usually in the form of additional checks, approvals and reviews in the upstream process and slowing down the source-to-contract cycle while limiting the portfolio of available viable supplier prospects. This turns into a vicious circle of continued decrease of competitiveness so that preventive measures become inhibiting obstacles to drive innovation, agility and competitiveness.

An important concept of guiding the most effective and efficient supply chain/procurement initiatives is utilizing a formalized risk appetite. It sets boundaries on the willingness to explore the optimum risk utilization. The risk appetite definition details to what extent exposure should be assumed to achieve strategic and operational goals, sustain competitiveness, and increase agility.

Formalizing risk appetite: Key benefits

- Align business imperatives and supply chain/procurement goals. Connect business and supply chain/procurement strategies.
- Elevate risk management to become more comprehensive and relevant.
- Drive continuous discussion at the executive level on risk management as a driver to thrive in uncertainty.
- Improve the long-term prospects of the company.

However, it typically is not among the first items on the checklist when reviewing a company, its strengths, weaknesses, positioning and competencies. Alongside the vision and mission statement, a well-defined risk appetite is the key to success aligning all activities. When nonexistent, or not well-defined, it can cause ineffectiveness, inefficiencies and misalignment. This is not a new concept but it is widely underutilized. Only 35% of companies reportedly have a formal overarching risk appetite statement, and even less (11%) have reached the maturity level of business unit customized risk appetite statements.

Secondary research conducted across Fortune Global 500 companies confirms the outcome. Only 35 companies mention risk appetite in their shareholder report, some very vaguely. And only two have it in actual reference to their sourcing strategy, with one company having developed detailed KPIs to monitor and report out.

It is increasingly important with a faster-paced global economy with more interdependencies and higher complexities across value chains to have a well-defined risk appetite. This research addresses the concept of formalizing risk appetite and its application to supply chain/procurement.

Define risk appetite

The underutilization of the risk appetite concept creates an environment of individualized, ad hoc decisions based on siloed short-term targets. With that, risk management is focused on postrisk event impact containment, correction and recovery as earlier described — a value-leakage minimization activity. The risk appetite statement, however, helps to turn risk management into a value creation lever.

A recent survey shows that 89% of companies experienced a supplier risk event in the past five years, yet company awareness and plans to mitigate it lack maturity. There is near certainty that a risk event will happen during a relationship with a supplier, with most events attributed to supplier financials, capacity or compliance issues.

Most of the events are likely to be nonsystematic, which are generally tolerable, locally confined and can be contained with short-term reactive measures. Few are systematic impact events, where failures can bring down the entire system. These events require rapid and decisive measures to guarantee survival through quick containment, root cause analysis, corrective action and recovery. Research shows that almost two-thirds of companies do not immediately become aware of the issue and only react with delay, which complicates containment and recovery efforts and increases the quantifiable negative exposure. Many stakeholders point directly to supply chain/procurement for ownership and call for action.

Gartner recommends supply chain/procurement leaders take the following three actions:

1. Own the process and start with the stakeholder in mind and in focus.
2. Assess and align goals, mindset and requirements.
3. Complement and communicate while building the risk appetite statement.

Build a framework to continuously predict, assess and manage sourcing risks

In comparison to the low percentage of companies having a defined risk appetite and monitoring process, 81% of companies have a formal risk committee that should monitor and guide responses to risk events.

The existence of a risk committee does not improve the awareness of existing, emerging and obsolete risks, with 53% not becoming immediately aware of risk events occurring. Therefore, utilizing risk appetite statements as means of thriving in uncertainty needs to include an effective and efficient oversight. The oversight needs to assess current and emerging risks, the relevancy of the risk appetite and propose any adjustments to it to stay current, considering also any external or internal changes impacting the business model.

Regardless of whether a formal risk committee is already established or not, the structure, composition, abilities and mandates need to be purpose-driven to ensure alignment and enablement with its mission. If existing, assess and review it against these goals, or if creating the oversight due to its prior nonexistence, ensure to frame it effectively and efficiently.

A cross-functional oversight will be most impactful if chaired by the leader responsible for supplier risk management, often the chief supply chain officer or chief procurement officer. A fixed cadence for standard reviews and emergencies should be established. By risk category, the response teams should be established to act timely on any risk event occurrence without requiring a debate about the response team leadership, type of abilities and reactions. A risk event is a shared responsibility. The activities surrounding containment, corrective actions and recovery are cross-functional in many cases. A core responsibility for the risk committee is to provide proactive and predictive measures and reaction plans before an event occurs. This will ultimately have the biggest impact to drive cross-functional collaboration while minimizing the time to recover and value at risk.

Incorporate technology solutions to optimize performance and help achieve expectations

Regardless of your risk appetite, technology has proven to be a catalyst for improved risk management. Use technology as risks evolve and new risks emerge with increased complexity, impact and velocity since the risk management efficacy of assessing, monitoring and utilizing risk needs to follow. Most leading organizations have automated risk assessment and monitoring, while the decision-making process is supported with data transparency, normalization and relevant correlation. This equips the functional leaders with the best information to make quick and qualitatively high-risk reward decisions. A close dialogue with finance and IT will facilitate the budgeting, assessment and implementation of these technologies. Apply an extended view of the return on investment for these implementations as part of the maturity curve evolvement and value leakage avoidance. The adjusted financials will often outweigh the expenses when the selection is made for proven tools to be implemented and scaled most impactful in the risk management process. Companies utilizing technology in risk management increase their effectiveness in supplier risk tactics by almost two times.



An increasing number of tools are becoming available in the market especially for supply chain/procurement monitoring, supplier financial risk assessment (most effective for public companies) and other geopolitical risk, and supply news assessment to provide real-time insights to category managers. A cautious and purpose-driven evaluation is recommended since few, if any, of these tools have predictive analytics capabilities built into them, although vendors claim they are developing machine learning and artificial intelligence to spot potential issues. Therefore, evaluate and implement the most appropriate tools for the process in a bimodal approach. Keep the risk management process with the described oversight while complementing insights either through new data sources or focus on increasing the process velocity and agility by exchanging manually intensive research and analysis activities by technology and automation. Either focus will drive risk awareness in the value chain and increase the ability of supply chain/procurement to orchestrate and predict more accurately, and to put corrective measures in action faster, reducing value at risk and time to recover while maximizing time to survive.

About Gartner

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Supply chain risk management: How we help

Key tenets of supply chain risk management are enhancing resilience and improving competitiveness. But supply chain risk management today must account for unprecedented, fast-developing market disruptions as well as transformation inside the organization, making it difficult to achieve agility and competitive advantage. To succeed, supply chain risk management must be a collaboration between supply chain, procurement and enterprise risk management (ERM) managers. Innovative technology solutions and advanced analytics enable continuous review and integration of supply chain risk management with the business. Gartner provides supply chain leaders with insights, advice, data and tools to increase supply chain risk readiness. Visit gartner.com to learn how we enable supply chain risk management to combat disruption.



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